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IN THE

Supreme Court of the United States

October Term, 1941

No. 806

PAUL E. MANHEIM, as a Committee, and THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK, as Trustee,
Petitioners,

against

VAN S. MERLE-SMITH, *et al.*, J. P. MORGAN, *et al.* and J. HERBERT CASE, *et al.*, Contracting Committees, The City of New York, the Transit Commission and all other parties to Plan and Agreement to end the receivership of Interborough and Manhattan Companies, Thomas E. Murray, as Interborough Receiver, and William Roberts, Receiver of Manhattan Railway Company,
Respondents.

REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

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Preliminary Statement.

Paul E. Manheim, on his own behalf and on behalf of the owners of the bonds represented by him (hereinafter sometimes called "petitioners") has adopted the somewhat unusual procedure of filing a reply brief as permitted by Rule XXXVIII because the brief in opposition, filed on behalf of the City of New York and others, reveals a fundamental difference of approach to the problems presented by this case.

Our opponents' argument is based upon two premises:

First: That this is a conventional reorganization case, from which they argue that the Unification Plan meets the standards of this Court's decisions in *Case* v. *Los Angeles Lumber Products Co., Ltd.*, 308 U. S. 106, and *Consolidated Rock Products Co.* v. *DuBois*, 312 U. S. 510.

Second: That all holders of Manhattan Second Mortgage Bonds are members of a single class of creditors of Interborough, from which they argue that the consent of Curtis, Belknap & Webb, attorneys for the Rockefeller interests, holding approximately 60% of the issue, as well as various other securities of Interborough and Manhattan, is binding upon all.

For the purposes of this reply brief we shall accept these premises, upon which the decision of the Circuit Court of Appeals in this case stands for two propositions:

1. Where an outsider offers to purchase the assets of a receivership estate, that purchaser may dictate the manner in which the price he proposes to pay shall be distributed among the claimants against the estate, and the Court may approve such allocation, though it violate the rule of absolute priorities between creditors and stockholders, as set forth in decisions of this Court.

2. All of the members of a class may be bound to a compromise of the legal rights of that class by the consent of members not purporting to act for others, and concededly having conflicting interests.

We think it clear that under applicable decisions of this Court, these propositions are untenable, and sanction a procedure by which the District Court so far departed from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision.

POINT I.

The Plan is Demonstrably Unfair.

The Unification Plan and the fairness of the offers thereby made to all security holders, including Petitioners and all other holders of Manhattan Second Mortgage Bonds, was submitted to and passed upon by the District

Court. On March 15, 1940, the District Court, after hearing, entered its order (R. 419) in which it found, ordered, adjudged and decreed that the Unification Plan "is fair, equitable and feasible, and the offers made in the Plan to creditors and stockholders of Interborough Rapid Transit Company and of Manhattan Railway Company, are fair, equitable and timely." On June 12, 1940, the District Court signed orders confirming the sales of the Interborough and Manhattan properties to the Contracting Committees, "acting pursuant to the Plan" (R. 241, 243; 273, 277), and an order "authorizing and directing consummation of the plan," (R. 456) all referring to its finding "the Plan to be fair, equitable and feasible and the offers made therein to creditors and stockholders of Interborough and Manhattan fair, equitable and timely." Petitioners appealed from each of these orders and from each and every part thereof (R. 19, 20, 25, 26). These were among the orders affirmed by the Circuit Court of Appeals.

Our opponents' brief stresses at many points the contention that Petitioners' position is purely that of creditors of Interborough. Again, for purposes of this reply brief, we shall accept the premise. Upon it, a single illustration will suffice to make our point. Nowhere in this Record does there appear any determination of the amount of the claims of Manhattan parties as Interborough creditors, against which the adequacy of the offers made to them in the Plan could be appraised. Yet the holders of 350,000 shares of Interborough Common received $3 a share, a total of $1,050,000 (R. 98, 154, 155).

The Record indicates some slight confusion as to precisely where responsibility rests for the Interborough stockholders' participation under the Plan. Our opponents' brief, (p. 13) interprets the Plan as "a series of offers by an outside purchaser to the holders of Interborough and Manhattan securities" and quotes (p. 5) from the opinion of Judge Swan as follows:

> "The Record reveals that the City desired not only to acquire the property but also to satisfy security holders without eliminating any class. . . ."

The opinion of the District Court (R. 408) states:

> "But the primary distinction here is that the money to be paid to the stockholders comes from an outside purchaser, the City, which does not pay a lump sum into court to be fought over by those with claims, but which makes the price divisible into portions for the various classes of claimants on a basis that, for practical purposes, is quite clearly a fair one."

On the other hand, counsel for the Transit Commission stated to the District Court (R. 580-581):

> "Of course, from the point of view of the City, the purchaser, or the Transit Commission, the State organization that has to act as the check and balance on the City, it is quite immaterial who gets the portions or any particular portions of the purchase price. It is the purchase price that is important from the point of view of the City."

With particular respect to the participation of Interborough stockholders, the District Court's opinion reads (R. 409):

> "It was stated at the hearings that the inclusion of a small amount for stock was insisted upon by counsel for the Transit Commission because it was felt that there was a value in the stock, however small."

Regardless of where the responsibility for the Interborough stockholders' participation may rest, the opinion of the District Court seeks to sustain it upon the authority of the *Los Angeles* case, stating:

> "The tender of $3 per share to stockholders is by way of compromise, . . . The opinion in the *Los Angeles* case, *supra*, made mention that settlement of disputed claims by compromise rather than by protracted litigation is proper and reasonable" (R. 408).

The opinion continues, however, to justify the "compromise" as follows:

> "In case the present plan and agreement were to be disapproved on the score of stockholder participation, there is every likelihood that it would be amended so as to drop out the stockholder participation without corresponding advantage to any class of creditors but with the disadvantage of further delay and uncertainty" (R. 409).

This language is strangely reminiscent of the argument of the proponents of the *Los Angeles Lumber Products* plan, which this Court disposed of as follows (308 U. S. 106, 129):

> "The conclusion of the District Court that avoidance of litigation with the stockholders gave validity to their claim for recognition in the plan involves a misconception of the duties and responsibilities of the Court in these proceedings. Whatever might be the strategic or nuisance value of such parties outside of § 77B, is irrelevant to the duties of the Court in confirming or disapproving a plan under that section. In these proceedings there is no occasion for the court to yield to such pressures. If the priorities of creditors which the law protects are not to be diluted, it is the clear duty of the Court to resist all such assertions."

It is submitted that if "there was a value in the stock, however small" the District Court has held that the Interborough receivership estate was of sufficient value to sustain a payment in full of all Interborough creditors, (including by hypothesis, Petitioners) and leave a balance for the stock. Yet upon this Record, neither Manhattan claimants nor the Court could judge whether or not the offers made were or were not full payment.

Clearly the criterion of fairness established by this Court's decisions in *Northern Pacific Railway* v. *Boyd*, 228 U. S., 482, and in the *Los Angeles Lumber* and *Consolidated Rock Products* cases is not met. That criterion

> "does not . . . require the impossible and make it necessary to pay an unsecured creditor in cash . . . If he declines a fair offer . . . having refused to come into a just reorganization, (he) could not, thereafter be heard in a Court of Equity to attack it." (228 U. S. 482, 508.)

The *Los Angeles* and *Consolidated Rock Products* cases clearly set forth the requisites of a fair offer. They make clear that the creditor must be offered cash or new securities, having at least a potential value equivalent to the full amount of his claim plus interest, before stockholders can receive anything except for new money or money's worth.

In *Taylor* v. *Standard Gas & Electric Co.*, 306 U. S. 307, the *Los Angeles* and *Consolidated Rock Products* cases, this Court rejected plans of reorganization based upon compromises, not because they were compromises but because the issues compromised were, in its judgment, not "close questions of interpretations of after acquired property clauses in mortgages, preferences in stock certificates, divisional mortgages and the like . . ." which might "give rise to honest doubts as to which security holders have first claim to certain assets." (308 U. S. 106, 130.)

If there was any value in the Interborough stock, Interborough must have had sufficient assets to pay its creditors in full. In the circumstances, the District Court in the exercise of the "informed, independent judgment," required by this Court's decisions in *National Surety Co.* v. *Coriell*, 289 U. S. 426 and the subsequent reorganization cases, had at least the duty of determining what would constitute full payment of Manhattan parties' claims against Interborough.

This it did not do—unless the "Settlement Fund Order" of March 15, 1940, based upon the so-called "compromise" of non-assenters' rights accomplished it. We submit that it did not. (*Infra*, Point II.)

We have quoted (*supra*, p. 4), Judge PATTERSON's opinion as to "the primary distinction" that the City "makes the price divisible into portions for the various classes of claimants." Judge SWAN's opinion is equally plain:

> "The City's offer was made to satisfy security holders as well as to secure the properties, and having done so so successfully we will not disturb the Plan on the ground that different offers should have been made" (R. 961).

This proposition is of sweeping application, far beyond the particular facts of this case. It clearly belies our opponents' statement (Brief, p. 37): "This case is *sui generis* if any case ever was." The mere fact that the purchaser, in this case, was the City of New York will not prevent reliance upon the opinions as authority in any reorganization proceeding or in proceedings under § 11(b)(2) of the Public Utility Holding Company Act of 1935, where the tribunal must determine the fairness, equity and feasibility of plans of reorganization or recapitalization. Unless this decision be corrected, the argument can and will be made that while the preponderance of security holder support of a particular plan cannot, under the applicable decisions of this Court, relieve the tribunal of its duty of exercising an "informed, independent judgment" it lies within the power of a proposed purchaser to require the tribunal to abdicate that function.

POINT II.

The "Compromise" Must Fall for Want of Consent.

Having, justifiably we submit, rejected an unfair offer of participation under the Plan, Petitioners were called upon to and did participate in the so-called class action, in which the rights of non-assenting claimants against the estates were "compromised".

Our opponents argue (Brief p. 27):

> "Moreover, the Second Mortgage Bonds were fully represented before the Court, not only by counsel for Petitioner Manheim, but also by Chase Bank as Trustee of the Manhattan Second Mortgage, by Curtis, Belknap & Webb, representing a majority of the Second Mortgage Bonds, and by the Wassner Committee, for such bonds, all of whom participated actively in the hearings."

This "representation", our opponents argue, constitutes "the adequate representation of all" required by Rule 23 of the Rules of Civil Procedure. For purposes of litigation this may be so. But there was no litigation. There was a "settlement" by "compromise", approved by the District Court upon the consent among Manhattan Second bondholders, only of Curtis, Belknap & Webb. That firm appeared as attorneys for holders of 60% of the Manhattan Second Mortgage Bonds, and repeatedly denied acting in a fiduciary or representative capacity (R. 91, 146, 454, 593). Their clients had assented to the Plan. It was necessary for the Plan to be consummated that the "compromise" be railroaded through on a basis acceptable, not to non-assenters, but to the Contracting Committees (our opponents' brief, p. 32; R. pp. 110 *et seq.*). The District Court's "settlement fund order", dated March 15, 1940, (R. 410) provided that it should be null and void "in the event that the Plan should not be consummated" (R. 418).

The "compromise", therefore, can be justified as to Petitioners only upon the theory that all Manhattan Second Mortgage bondholders were members of a single class, whether or not they assented to the Plan, and that Curtis, Belknap & Webb could give consent for all the members of that class.

Again, for purposes of this reply brief, we shall adopt our opponents' premise. The Plan required as a condition to its consummation the consent of the holders of 66⅔% of the outstanding Manhattan Second Mortgage Bonds (R. 130). Curtis, Belknap & Webb concededly appeared as attorneys for the holders of 60% of the Manhattan Second Mortgage Bonds. But their clients also held substantial amounts of Interborough and Manhattan First Mortgage Bonds (R. 316). In that position, they could not, even had they so desired, validly give consent for any other Manhattan Second Mortgage bondholder. *American United Mutual Life Insurance Company* v. *City of Avon Park, Fla.*, 311 U. S. 138.

It is respectfully submitted that it was not the intention of this Court to sanction such procedure by its approval, in the *Los Angeles* and *Consolidated Rock Products* cases, of the practice of compromising difficult issues in reorganization.

POINT III.

The Status of Petitioners.

Our opponents apparently seek to create the impression that Petitioners are disappointed gamblers. Their brief (p. 14) refers to the price at which Manhattan Second Mortgage Bonds had sold on the New York Stock Exchange for some years prior to the adoption of the Plan, and states in a footnote:

> "The Record does not disclose when, or at what prices the bonds represented by Manheim were purchased, . . ."

The Record does not disclose that such information was ever asked for. Nor is this a bankruptcy proceeding, to which Section 211 of the Bankruptcy Act is applicable. Our opponents carefully avoid a charge that Petitioner

Manheim's own bonds were purchased at the prices referred to in their brief. Such is not the fact, to our opponents' knowledge.

Our opponents also emphasize the statement in the opinion of the Circuit Court of Appeals (R. p. 955):

> "He (Manheim) asserts no wish to upset the transfer of the properties to the City or to change the participation of assenting security holders. . ."

from which Judge SWAN drew the inference that the scope of Petitioners' appeal was limited to attacking the treatment of non-assenters.

Petitioners' position in this reply brief is directly analogous to that of the First National Bank of Cincinnati in *First National Bank* v. *Flershem*, 290 U. S. 504. To sum it up:

1. Petitioners were entitled to a fair offer of participation under the Plan;
2. Not having received such an offer, they were entitled to reject the offer made, and to receive instead the amount they would have got upon a proper distribution of the proceeds of the sale.
3. A favorable result upon Petitioners' appeal under equity procedures need not necessarily involve changing the participations of assenting security holders. Such was the result in the *Flershem* case. Such is the result here sought.

Conclusion.

We think we have amply demonstrated, upon premises put forward by our opponents:

> That, considered as a reorganization case, the opinion of the Circuit Court of Appeals stands for a pro-

position clearly untenable under applicable decisions of this Court;

That the so-called compromise of non-assenters' rights was arrived at by a procedure so unusual and so prejudicial as to call for the exercise of this Court's power of supervision;

That the questions here involved are of wide public interest and importance.

A writ of certiorari to the Circuit Court of Appeals for the Second Circuit should be granted.

Dated: New York, January 21, 1942.

Respectfully submitted,

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Counsel for Petitioner Manheim

CARLOS L. ISRAELS
on the Brief

For the reasons more fully set forth on pages 28 and 29 of the Petition for Writ of Certiorari, the undersigned, Counsel for Petitioner The Chase National Bank of the City of New York, as successor Trustee under the Mortgage under which the bonds owned or represented by Paul E. Manheim are outstanding, adopts the foregoing brief for the sole purpose of protecting the rights, if any, of Paul E. Manheim and of the holders of said bonds.

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